Supreme Court, U.S.
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No. 95-625

In The

Supreme Court of the United States

October Term, 1995

IN RE: HOLYWELL CORPORATION and THEODORE B. GOULD,

Petitioners,

Petition For A Writ Of Mandamus To The United States Court of Appeals For The Eleventh Circuit And To The United States District Court For The Southern District of Florida, Senior District Judge Sidney M. Aronovitz

REPLY BRIEF FOR THE PETITIONERS

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REPLY BRIEF FOR THE PETITIONERS

The respondents' briefs show the importance of granting the petition for writ of mandamus to clarify the meaning of this Court's opinion, cited as *Holywell Corporation v. Smith*, 503 U.S. 47, 112 S.Ct. 1021 (1992). In fifty years of teaching, editing law journals on taxation, and practicing law, counsel for the petitioners is not aware of another case that has so far departed from the expected judicial standard as have these proceedings.

These proceedings have been characterized by fraud, and the opinions of lower courts have been based on a complete lack of understanding of the laws applicable to the conduct of fiduciaries and of the tax laws.

In the prior proceedings before *this* Court, respondents Fred Stanton Smith ("trustee") and The Bank of New York ("Bank") argued that (a) the trustee's duties were specifically defined and limited by the Bank's court-approved plan, (b) it was the intent of the Bank's plan that Smith would be treated as a disbursing agent with only ministerial duties and relieved of the statutory obligation as a fiduciary to pay taxes[1] and of personal liability as an officer of the court, and (c) the tax liabilities related to the trustee's implementation of the Bank's plan should be imposed on the reorganized debtor.[2]

The United States of America was a respondent to the petition for writ of certiorari filed by the petitioners,[3] upon which this Court's *Holywell* opinion was entered. A separate petition for writ of certiorari was filed by the United States. The differences between the arguments of the United States and the petitioners have been explained

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[1] See *In re Holywell Corp.*, 911 F.2d 1539, 1545 (11th Cir. 1990).

[2] *Id.* at 1545.

[3] The Solicitor General has not filed a brief in opposition to this petition for writ of mandamus.

in this Court's opinion, see 112 S.Ct. at 1026. The Solicitor General's argument that the trustee was the fiduciary of a Chapter 11 estate was rejected, *Id.*, and the Solicitor General conceded in oral argument that

> [t]he collateral consequence . . . if the trustee is deemed to be an assignee is somewhat significant. . . . The United States would have an absolute priority for the payment of taxes under the Absolute Priority statute [31 U.S.C. § 3713(a)(1)], instead of a bankruptcy priority under [11 U.S.C. §] 503(b)(1) of the [Bankruptcy] Code and under the plan, and the trustee would also be personally liable for taxes under [31 U.S.C. §] 3713(b). S.Ct. Transcript, December 4, 1991, p. 15.

The Solicitor General also conceded that the Miami Center Liquidating Trust was a separate taxable entity and explained "[t]he only concession that we ever made about separate taxable entities is what the statute says. [Section] 1399 of the Internal Revenue Code says that when a corporation goes in, its estate is not a separate taxable entity. . . . " *Id.* at 49; also 112 S.Ct. at 1027, n.1.

This Court concluded that "[a]s the assignee of 'all' or 'substantially all' of the property of the corporate debtors, the trustee must file the returns that the corporate debtors would have filed had the plan not assigned their property to the trustee," 112 S.Ct. at 1025, and that "[n]o tax liability becomes due under § 6151 until the time required for making those returns," 112 S.Ct. at 1028.

Thus, under the provision for a modified form of substantive consolidation in the Bank's plan, see Pet. 3, the trustee was required, as the assignee of Holywell's property to file a federal corporate income tax return on October 15, 1985, for the fiscal tax year ended July 31, 1985, and, after the payment of Holywell's liabilities, to cause a dividend distribution of the assets of both Holywell and its nondebtor subsidiaries to the Miami

Center Liquidating Trust, for the trustee's use to pay creditors of the various bankruptcy estates, 112 S.Ct. at 1024. Thereafter, the trustee was required to file a fiduciary return on a calendar year basis. 26 U.S.C. § 645.

The transfer of the property of the individual debtor's estate to the "new Miami Center Liquidating Trust," 112 S.Ct. at 1026, which was a separate trust distinct from the bankruptcy estate, *Id.*, was a taxable event and caused recognition of a taxable gain of $38,800,000, compare Pet. 29 citing 26 U.S.C. § 1398(i), [transfer to debtor is not treated as a disposition upon estate's termination], and the trustee was required, under the provisions of the Bank's plan, to sell the Miami Center to M C Holdings Partners, the Bank's alter ego, forty-five days *after* the plan's Effective Date. Art. I of the Bank's Plan, *Definitions*, "Miami Center Closing Date," p. 9.

Instead of seeking the court's instructions, or a ruling from the Internal Revenue Service, concerning the priority for the payment of postconfirmation taxes and clarification of his fiduciary duties as the transferee of a taxpayer's property, Smith sought the Bank's indemnification holding him personally harmless, see Pet. 7, n. 4, and sold the Miami Center *on* the plan's Effective Date of October 10, 1985. Now the trustee contends, as he did in the prior proceedings before this Court, that "he was a stranger to the proceedings,"[4] Smith Br. 4, and failed to

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[4] The Joint Appendix to the previous proceedings before this Court includes the testimony of Irving M. Wolff, the trustee's former attorney, concerning the trustee's reasons for demanding the Bank's indemnification:

> "To save the Liquidating Trustee harmless as a result of the execution of the contract by him as Liquidating Trustee so that if any claims were made upon the Liquidating Trustee for payment of unpaid taxes, i.e., Internal Revenue Service claims, which would result

establish a reserve for the payment of income taxes "as no tax consequences were expressly imposed on the Trust under the plan," Smith Br. 5.

The Bank failed to disclose until after the trustee caused the plan's substantial consummation that its prior representations were false as to the means for execution of the Bank's plan, specifically that the proceeds from the sales of the Washington Properties and the Miami Center would be adequate to pay "city and county taxes, the IRS, all of the creditors in these estates." (Bkrtcy. S.D. Fla., Transcript, May 31, 1985, p. 127) The Bank disavows its previous argument in this Court that the plan's intent was to relieve the trustee of his fiduciary duty to pay taxes and to defeat the express absolute statutory priority of the United States for the payment of debts to the government.[5]

Instead, the Bank relies on the settlement negotiated with the trustee limiting the Bank's liability for negligent misrepresentation to $15 million subject to the condition that the Bank could impose postconfirmation liabilities exceeding $27 million on the Trust estate for the plan's wrongful subordination of the Miami Center Joint Venture's ("MCJV") claim for unpaid rent and for the trustee's failure to pay the indubitable equivalent of MCJV's property from the Miami Center's sale proceeds, Bank Br. 6.[6] Compare, *In re Holywell Corp.* (Bank of New York v. Olympia & York Florida Equity Corp., Theodore

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from the sale and transfer of the property at the closing. . . . "

[5] Brief In Opposition Of Respondent Bank of New York, p. 9. ("the IRS attempts to rely on statutory authority independent of the Plan to impose upon the Liquidating Trustee tax obligations that are outside the scope of his authority.")

[6] See the related petition for writ of certiorari, No. 95-608; also, Pet. 13, n. 9; Pet. 16, n. 13.

B. Gould, and Miami Center Joint Venture), 913 F.2d 873, 880 (11th Cir. 1990).

Notwithstanding the question presently before the Eleventh Circuit of whether the respondents engaged in fraud and conspiracy to damage the business interests of the petitioners, Bank Br. 7, n. 10, the petition for a writ of mandamus concerns only the following specific issues:

Are the prevailing parties in the prior proceedings before this Court entitled to mandamus under 28 U.S.C. § 1651(a) to clarify the mandate of the Court's *Holywell* opinion with respect to a district court's authority to refer to a bankruptcy judge to hear and enter a final judgment in the proceedings remanded for hearings in conformity with this Court's opinion? Pet. 20.

Are the lower courts bound by this Court's *Holywell* opinion as the law of the case with respect to whether the trustee "breached his duty either under the terms of the [Bank's] Plan or other statutory provisions," Pet. 24, and is the Miami Center Liquidating Trust a new separate taxable entity distinct from a bankruptcy estate? Pet. 28.

The importance of clarifying this Court's mandate is illustrated by the different opinions of the lower courts,[7]

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[7] *In re Pizza Pronto, Inc.*, 970 F.2d 783, 784 (11th Cir. 1992) (treating a trustee appointed under Chapter 7 in the same manner for tax purposes as the trustee of the Miami Center Liquidating Trust). *In re Hartman Material Handling Systems, Inc.*, 141 B.R. 802, 813 (Bkrtcy. S.D. N.Y. 1992) (Section 505 does not provide authority for a bankruptcy court to rule on postconfirmation tax effects); *In re Polysat, Inc.*, 152 B.R. 886, 891 (Bkrtcy. E.D. Pa. 1993) (postconfirmation liabilities are not justiciable in bankruptcy court); *In re Williams*, 152 B.R. 123, 128 (Bkrtcy. N.D. Tex. 1992) (trustee acting as fiduciary of a liquidating trust created under provisions of confirmed plan is "not a bankruptcy trustee"); *In re Hallock*, 154 B.R. 297, 302 (Bkrtcy. D. Ariz. 1993) (Bankruptcy court lacks subject matter jurisdiction under 11 U.S.C. § 505 unless "issues relate to the bankruptcy estate or to

published articles,[8] and the Internal Revenue Service's revision of the Revenue Procedures concerning liquidating trusts. See Rev. Proc. 94-45, 1994-28 IRB 124 (1994).

ARGUMENT

1. *"Bankruptcy Judges Have Authority To Exercise Broad Jurisdiction Exceeding The Powers Of A District Judge."* Respondents' contention is wrong that bankruptcy courts have authority as a second tax court system (a) to determine the amount of postconfirmation taxes for which the trustee is liable as an assignee of Holywell's property, (b) to authorize the payment from the Miami Center Liquidating Trust's funds of the tax liabilities asserted against Holywell Corporation & Subsidiaries,[9] and (c) a bankruptcy judge has authority to enter a final judgment concerning causes of action cognizable only under State common law, alleging fraud, conspiracy, negligence, misconduct, willful default, and breach of fiduciary duty, Smith Br. 13, Bank Br. 7.

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discrete issues concerning whether a particular tax is nondischargeable").

[8] *Holywell Corp. v. Smith*: *Partially Clarified Tax-Paying Duties For Bankruptcy Trustees*, Moran 46 Tax Law 567; Journal of Taxation, June 1992. Procedure, *Liquidating Trustee Must File Returns And Pay Tax For Debtors, Supreme Court Says*, Culp 76 JTax 342; *Once Dust Settles, Uncle Sam Appears As Uninvited Guest*, Cudd & Grimes, NY Law Journal, February 17, 1994).

[9] The trustee's estoppel argument in reliance on the petitioners' Application for Stay, Smith Br. 16, fails to disclose the material fact that $29,307,913.48 was transferred to the trustee on October 11, 1985, and that, prior to January 31, 1991, the trustee disbursed $23,106,212.34, of which $19,492,154.97 was the cash of Holywell and its nondebtor subsidiaries. After Justice Kennedy denied the stay on January 22, 1991, the trustee disbursed an additional $11,220,160.52 without first establishing a reserve for the payment of federal and state income taxes.

Respondent's argument is contrary to this Court's historical precedent concerning the separation of powers,[10] the plain meaning of the laws prohibiting courts from entering declaratory judgments with respect to taxes, 28 U.S.C. § 2201, and restraining the assessment or collection of the tax liabilities asserted against a transferee or fiduciary, 26 U.S.C. § 7421(b), and also precedent preventing a fiduciary from using the assets of a separate taxable entity from paying the taxes of another taxpayer.

Under the Bankruptcy Amendment and Federal Judgeship Act of 1984, the bankruptcy powers have been conferred on federal district courts and a bankruptcy judge's authority to adjudicate a proceeding for a bankruptcy court to enter a final enforceable order is limited to "cases under title 11 and core proceedings arising under title 11, or arising in a case under title 11," see Pet. App. 64; also *Celotex Corp. v. Edwards*, 115 S.Ct. 1493, 1499 (1995). Thus, the trustee's argument that the bankruptcy court had power to enter a final judgment on petitioners'

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[10] See *Northern Pipeline Const. v. Marathon Pipe Line Co.*, 102 S.Ct. 2858 (1982); *Buckley v. Valeo*, 96 S.Ct. 612, 683 (1976); *United States v. Will*, 101 S.Ct. 471, 481-482 (1980); *Toth v. Quarles*, 76 S.Ct. 1, 4 (1955); *Murray's Lessee v. Hoboken Land and Improvement Co.*, 18 How. 272, 284 (1855); *Crowell v. Benson*, 52 S.Ct. 285, 292 (1932); *Ex parte Bakelite Corp.*, 49 S.Ct. 411, 416 (1929); *Glidden v. Zdanok*, 82 S.Ct. 1459, 1471-1472 (1962); *Atlas Roofing Co. v. Occupational Safety Commission*, 97 S.Ct. 1261, 1266, n. 7 (1977); *Commodities Future Trading Commission v. Schor*, 106 S.Ct. 3245, 3256 (1986); *Thomas v. Union Carbide Agricultural Products Co.*, 105 S.Ct. 3325, 3334 (1985); *United States v. Griffin*, 58 S.Ct. 601, 602-603 (1939); *Granfinanciera, S.A. v. Nordberg*, 109 S.Ct. 2782, 2794 (1989), quoting *Schoenthal v. Irving Trust Co.*, 287 U.S. 92, 94-95 (1932), and 109 S.Ct. at 2803 (Scalia, J. concurring opinion) citing *Murray's Lessee* (personal liability of a fiduciary appointed as an officer acting on behalf of the United States for taxes owed as debts to the United States is not a judicial controversy); *Pernell v. Southall Realty Co.*, 94 S.Ct. 1723, 1733 (1974).

counterclaims subject only to the clearly erroneous standard of review is plainly wrong, Smith Br. 13.

In *Palmer v. Webster & Atlas National Bank*, 312 U.S. 156 (1941), this Court held that a trustee who administered two different estates could not use the assets of one estate to pay the taxes of another (312 U.S. at 163). Here, the trustee relies on a bankruptcy judge's authority to approve a settlement using the Miami Center Liquidating Trust's funds to pay taxes asserted against Holywell Corporation & Subsidiaries in order to avoid the trustee's personal liability for misappropriation of Holywell's cash to pay claims against MCLP's estate. Now the trustee contends that there is no supporting evidence that the "Trust assets are traceable to Petitioner Gould's estate." Smith Br. 17, n.11. Compare, *supra* at 6, n. 9. However, on October 21, 1985, counsel for the Bank and the trustee each reaffirmed that Holywell was nothing but a "shell" and "an entity devoid of all of its assets." Transcript (Bkrtcy. S.D. Fla., C.P. No. 1062).

2. *"This Court's Holywell Opinion Is The Law Of The Case In The Courts Below And It Is For This Court To Construe Its Own Mandate."* – Respondents' contention that mandamus is not available to review conclusions of the courts below, Smith Br. 15, Bank Br. 8, citing *Bankers Life & Casualty Co. v. Holland*, 346 U.S. 379, 383 (1953) misconstrues this Court's precedent for the issuance of mandamus. The rule is "[w]hatever was before the Court, and is disposed of, is considered as finally settled. The inferior court is bound by the decree as the law of the case; and must carry it into execution, according to the mandate," Pet. 24, quoting *Ex Parte Sibbald v. United States*, 12 Pet. 488, 492 (1838).

This Court held that the Miami Center Liquidating Trust is a "new" separate trust, distinct from a bankruptcy estate, and that it fits the description of a liquidating trust under the provisions of the Internal Revenue Code, 112 S.Ct. at 1026. Nevertheless, the courts below

have sanctioned the trustee's use of net operating losses of other entities in violation of 26 U.S.C. § 1398(i) without seeking the value of such NOLs from the Bank as damages for negligent misrepresentation as the plan's proponent and use of the liquidating trust's funds to pay taxes asserted against Smith as an assignee of the corporate debtors' property.

The bankruptcy court's factual findings, drafted by the trustee's attorney in order to relieve the trustee of liability for negligence and breach of fiduciary duty, see Pet. 7, n.14, that (a) "the debtors and their accountants led the Trustee to believe they would file tax returns and pay taxes," Smith Br. 9, (b) "[t]he debtors failed to present evidence of the potential tax liabilities of the plan at confirmation," *Id.*, and (c) "the Trustee demanded an indemnity agreement because, unlike the debtors or the bank, he was in no position to investigate or know the consequences of implementing the plan . . . [and] he was not a party to any of the proceedings prior to confirmation," Smith Br. 11, had been argued and unsuccessfully relied upon in the prior proceedings.

As the prevailing parties in the prior proceedings before this Court, the petitioners seek the issuance of mandamus to compel execution of this Court's mandate in the court below that the Miami Center Liquidating Trust is a simple ordinary trust for tax purposes separate and distinct from a bankruptcy estate, and the trustee's breach of fiduciary duty could not be reexamined in the remanded proceedings. See *City Bank of Fort Worth v. Hunter*, 152 U.S. 512, 515 (1893), citing *In re Washington & Georgetown Railroad*, 140 U.S. 92, 95 (1891). ["The question is merely as to the form of proceeding which this court should adopt to enforce the execution of its own mandate in the court below."]

For the foregoing reasons, and for the reasons stated in the petition, the petition for writ of mandamus should be granted.

Respectfully submitted,

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